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NO. [redacted] 121

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1955

CAMP WOLTERS ENTERPRISES, INC.,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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COMMERCIAL RECORDER, FORT WORTH, TEXAS—[illegible]

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v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

Camp Wolters Enterprises, Inc. prays that a writ of certiorari issue to review the decision entered in this case on February 29, 1956, by the United States Court of Appeals for the Fifth Circuit (R. 171-181) affirming a determination of The Tax Court of the United States (R. 58) that petitioner was due deficiencies in 1948 and 1949 income taxes in the respective amounts of $80,279.19 and $23,314.31.

Opinion Below

The findings of fact and opinion of The Tax Court of the United States (R. 22-57) are reported at 22 TC 737. The opinion of the Court of Appeals for the Fifth Circuit (R. 171-181) reported at 230 F 2d 555, is set out in full in the appendix at pp. 16 to 29 of this petition.

Jurisdiction

The judgment of the Court of Appeals was entered on February 29, 1956. The jurisdiction of this Court is invoked under Section 7482(a) of the Internal Revenue Code of 1954 and Section 1254 of Title 28 U. S. Code.

Question Presented

The question presented by this proceeding, upon the answer to which the proper disposition of the proceeding turns, is whether the court below erred in holding and determining that certain unsecured non-negotiable installment promissory notes which were issued by petitioner as part consideration for property rights assigned to it constituted "securities" as that term is used in Section 112(b)(5) of the Internal Revenue Code of 1939.

If these notes did constitute "securities" within the purview of Section 112(b)(5) of the Internal Revenue

Code of 1939, then Section 113(a)(8)(A) of the Internal Revenue Code of 1939 would limit petitioner's basis for such property rights (and pro tanto, petitioner's basis for assets held primarily for resale and depreciable property, acquired in part therewith) to the basis of such property rights in the hands of petitioner's transferors, plus the amount of any cash passing in the two transactions.

The answer to the question whether the notes in this proceeding did or did not constitute "securities" will, therefore, determine:

(a) The amount of gain or loss sustained by petitioner in its fiscal years ended March 31, 1948 and March 31, 1949 from sales of salvaged buildings, materials and equipment in part acquired indirectly with such promissory notes; and

(b) The amount of depreciation sustained in the same two fiscal years with respect to depreciable assets also in part acquired indirectly with such promissory notes.

STATUTES INVOLVED

Internal Revenue Code (1939)

Section 112. Recognition of gain or loss.

(b) Exchanges Solely in Kind.—

(5) Transfer to Corporation Controlled by Tranferor.—No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation, and immediately after the exchange such person or persons are in control of the corporation; but in the case of an exchange by two or more persons this paragraph shall apply only if the amount of the stock and securities received by each is substantially in proportion to his interest in the property prior to the exchange. * * *

(c) Gain from Exchanges not Solely in Kind.—

(1) If an exchange would be within the provision of subsection (b)(1), (2), (3), or (5), or within the provisions of subsection (1), of this section if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph or by subsection (1) to be received without the recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

(h) Definition of Control.—As used in this section the term "control" means the ownership of stock possessing at least 80 per centum of the

total combined voting power of all classes of stock entitled to vote and at least 80 per centum of the total number of shares of all other classes of stock of the corporation.

Section 113. Adjusted Basis for Determining Gain or Loss.

(a) Basis (unadjusted) of Property.—The basis of property shall be the cost of such property; except that—

(8) Property Acquired by Issuance of Stock or as Paid-in Surplus.—If the property was acquired after December 31, 1920, by a corporation—

(A) by the issuance of its stock or securities in connection with a transaction described in section 112(b)(5) (including, also, cases where part of the consideration for the transfer of such property to the corporation was property or money, in addition to such stock or securities), * * *

* * * * *

then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such

transfer under the law applicable to the year in which the transfer was made.

STATEMENT

Petitioner corporation was chartered under the laws of Texas on April 3, 1947, with authorized capital stock consisting of 1,424 shares of common stock of the face or par value of $10.00 per share, all of which ($14,240) was subscribed and fully paid in in cash. Contemporaneously, the incorporators of petitioner corporation paid into the Treasury of the corporation as paid in surplus the sum of approximately $190,000 in cash so that petitioner corporation began business with cash capital of $204,240. (R. 33-34)

On April 7, 1947, Camp Wolters Enterprises, Inc. bought from the individuals who were its shareholders certain contractual rights held by them against the United States for which petitioner paid such individuals the sum of $412,504.80. Of this amount, $1,424 was paid in cash, and the balance paid by the execution and delivery to grantors of non-negotiable unsecured installment promissory notes of petitioner which, by their terms, were payable "on or before" their respective due dates, in the total face amount of $411,080.20. (R. 34-40)

The contractual rights so purchased arose under termination clauses in leases pursuant to which the Armed Forces of the United States took possession of

several thousand acres of land in the vicinty of the City of Mineral Wells, Texas, (these lands and all rights arising out of the leasing of the same to the United States were owned by petitioner's grantors on April 7, 1947) for the use as a training and induction center and proceeded to build thereon an extensive and expensive military installation consisting of many barracks, a power plant, a hospital, et cetera, laid extensive concrete paving, constructed water and gas pipe lines and used portions of the leased premises for a firing range which became contaminated with unexploded ammunition, and otherwise so altered the leased premises that it would have cost a minimum of $400,000 to $500,000 to restore the premises to anything like their original condition, which the United States, under its terminated leases, was obligated to do. (R. 26, et seq.)

After it had acquired the contractual rights above referred to, petitioner corporation purchased from the United States all of the buildings, equipment and other physical properties located on the Camp Wolters' lands (under its leases, the United States retained ownership of and had the right to remove those items from the leased premises) and paid to the United States for the assets so purchased: (1) the sum of $412,500 in cash, part of which petitioner had to borrow from the Republic National Bank at Dallas, Texas, and (2) as additional consideration petitioner surrendered and released to the United States the restoration claims which it had acquired at a cost of

$412,504.20. (R. 45). These claims had a then value of between $400,000 and $500,000. (R. 92-94).

The total consideration of $825,004.20 thus paid by petitioner corporation for the Camp Wolters' buildings, equipment, materials, et cetera, was apportioned by the petitioner ratably over the assets purchased, and was so recorded on its books and records. About sixty percent of the buildings acquired, and substantantially all of the materials and equipment acquired, were purchased by petitioner corporation for resale in the ordinary course of its trade or business and were so sold. When and as buildings, equipment or materials were salvaged and sold, the cost of same, as entered on taxpayer's books and records, was used in calculating the resulting gain or loss. Depreciation on buildings acquired and used for rental purposes was computed and deducted based upon cost similarly calculated. (R. 40).

The only stockholder of petitioner corporation who testified on that particular point testified that in his own personal income tax returns for 1947 and 1948, he reported the sale of his "restoration rights" to Camp Wolters Enterprises, Inc. as a taxable transaction and returned the resulting gain on the installment basis over the two-year period in which the notes were fully paid off. This witness was an attorney, and was legal advisor to several of the individuals who participated with him in the transaction. (R. 159-160).

In its opinion and decision below, the Circuit Court held: That the unsecured, non-negotiable, installment notes totaling $411,080.20 given by petitioner corporation, along with cash, as consideration for the restoration rights which, in turn, were used, together with other cash in the amount of $412,500.00, to acquire the Camp Wolters' buildings, equipment and materials (the proper basis for gain or loss and depreciation of which is the ultimate question in this proceeding) constituted "securities" within the purview of Section 112(b)(5) of the Internal Revenue Code of 1939; that because of this, under Section 113(a)(8)(A) of the Internal Revenue Code of 1939, petitioner's basis for the restoration rights, and its basis for the buildings, equipment and materials acquired in part therewith must be limited to the cost of such rights to petitioner's transferors, plus the amount of cash passing in the two transactions, which the Tax Court of the United States and the court below found to be $466,274.00.

Specification of Errors to Be Urged

The Court of Appeals erred:

1. In holding that the "building notes" involved in this proceeding constituted "securities" within the intendment of Section 112(b)(5) of the Internal Revenue Code of 1939, and that, accordingly, the basis to petitioner of the "restoration rights" acquired therewith and of the physical assets acquired through

exercising such rights, is governed by Section 113(a)(8)(A) of the Internal Revenue Code of 1939;

2. In holding and deciding that petitioner's aggregate basis for the assets involved in this proceeding did not exceed the sum of $466,274.00 and in failing and refusing to hold and determine that the aggregate basis of the said assets totaled not less than $827,354.20, and that the basis for gain or loss and depreciation of each individual asset so acquired was an aliquot portion of $827.354.20, rather than $466,-274.00;

3. In overstating petitioner's gain from sales within the taxable years 1948 and 1949 of buildings, materials and equipment, and in failing and refusing to allow adequate deductions for depreciation sustained within the taxable years.

Reasons for Granting the Writ

The writ should be granted for the following reasons:

1. The decision of the Court of Appeals was wrong;

2. Such decision is directly contrary to the holdings of this court in *United States v. Leslie Salt Company*, US , 76 S.Ct. 416 (March, 1956) and in *LeTulle v. Scofield*, 308 US 415 (1940).

one of importance
Internal Revenue

3. The question here involved is one of
in the proper administration of the Intern
laws.

in detail just why
below was wrong,
Before we proceed to discuss more in det decisions of this
the decision of the Court of Appeals below of internal rev-
and how it conflicts with applicable deci e:
court, three fundamental principles of i
enue taxation merit notice. They are: ls of art, the lan-
ites should be ac-

A. Unless constituting words of associated with
guage of internal revenue statutes s
corded the meaning ordinarily ass
such language;

nsferred between
stepped-up basis

B. In general, property transfe ized to the trans-
related taxpayers may acquire a ste e taxing act:
only where gain or loss is recognize
feror upon the transfer under the t s deemed a tax-

C. Every sale of property is made non-taxable
able occasion, unless specifically ma e.
by an express provision of statute.

duals sold prop-
In the case at bar, various individu and unsecured
erty rights to the petitioner for cash ry notes of pe-
non-negotiable installment promissory etimes referred
titioner corporation, hereinafter some o acquired were
to as "building notes". The rights so by petitioner in
used as part of the consideration paid l materials and
acquiring Camp Wolters' buildings,
equipment.

The Court of Appeals held that these so-called "building notes" constituted "securities" as that term was used in Section 112(b)(5) of the Internal Revenue Code of 1939 and that, because of this, a non-taxable transfer, rather than a purchase, ensued, and petitioner was required to use, pro tanto, its transferor's basis for such rights, rather than its own cost, as its basis for the Camp Wolters' buildings, equipment and material acquired in part therewith. This holding of the Court of Appeals was wrong for two reasons: (1) the obligations in question were not securities within the purview of Section 112(b)(5) of the Internal Revenue Code of 1939, and (2) the acquisition by a corporation of an equity interest in property solely through the issuance of *evidence of indebtedness* is a purchase and sale, not a non-taxable exchange. *LeTulle v. Scofield, Supra.* The result ought not to be, and is not, changed because a small amount of cash also passes in the transaction.

Carried to its logical conclusion, the opinion and judgment below would require that where the necessary control existed, every transfer of property by a stockholder or stockholders to his or their corporation made in whole or in part on credit must be deemed, pro tanto, a non-taxable exchange. We respectfully submit that if the Congress had intended every sale between a stockholder (or stockholders) and a controlled corporation to be non-taxable where part of the consideration for the transfer was the promise of the grantee to pay specified sums in the future, rather

than cash or its equivalent, regardless of how such promise was evidenced, it very easily could have used the phrase "stock or obligations" in Section 112(b)(5) of the Internal Revenue Code of 1939. The Congress did not use this all-inclusive term, however; it used the more restricted phrase "stock or securities".

The term "securities" is nowhere defined generally in the Internal Revenue Code of 1939, although it appears in the statute several times. On occasion, the term is used restrictively. At other times, the term "securities" is used in the ordinary business or commercial sense. Yet again, the term "securities" is used in the statute in the broadest possible sense. Where used restrictively, as in Section 23(k)(3) of the Internal Revenue Code of 1939, the term is narrowly and precisely defined so as to apply to a very limited class of obligations evidenced by particular forms of instruments. Where intended to be used in the ordinary or commercial business sense, as in Section 112(b)(5) of the Code, the term "securities" is not defined at all. Consequently, the meaning is neither restricted nor broadened, and the term is left to be construed in its usual business or commercial sense. Where intended to apply in the broadest sense possible, the term "securities" is again defined, but this time in a sort of "shot-gun" fashion intended to include nearly everything that the term could possibly encompass.

(b) Probably the broadest use of the term "security" to be found anywhere in the internal revenue

nal Rev-
s laid on
nated or
erally as
statutes, appears in Section 1801 of the Inte on of this
enue Code of 1939 where an excise tax wa *Company*,
the issuance of documents, "however desi held that
termed", that were of the class "known ge rate tax-
corporate securities". In a very recent decis aning of
Court, namely, *United States v. Leslie Salt* of 1939.
Supra, decided March 5, 1956, this court ard much
ordinary promissory notes issued by a corp there in-
payer were not "securities" within the m ppeals be-
Section 1801 of the Internal Revenue Code ch in this
In that case, the United States had put forw his Court.
of the same arguments in support of the tax
volved as were relied upon by the Court of A upon an
low in reaching the decision that it did rea ntrary to
case, but such arguments were rejected by th y popular
ircles, and

Because the decision below was bottomed such term
interpretation of the term "securities", co ; and be-
the meaning long ascribed to that term by holding of
understanding in business and financial ci the trans-
directly contrary to the meaning ascribed to s y for *cash*
by this court in *Leslie Salt Company, Supra* ion 112(b)
cause the court below held, contrary to the h al public, the
this court in *LeTulle v. Scofield, Supra*, that t and include
fer of an *equity* interest in property solely *usually pur-*
and evidences of indebtedness was a Section xes-Corpora-
nd to exclude

Among business men, lawyers and the general tens Law of
term "securities" is generally understood to mean a 229 and 230.
"bonds and debentures in certificate form" as "*us*
chased by investors" (Montgomery, Federal Taxes
tion and Partnership (1947) Vol. 1, page 212) and
"ordinary commercial promissory notes"—Merten
Federal Income Taxation (1942) Vol. 3, pages 229

(5) transfer rather than a purchase and sale, the decision below was wrong and should be reversed by this court.

Conclusion

For the reasons stated, this petition for certiorari should be granted.

Respectfully submitted,

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APPENDIX

IN THE
UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 15453

CAMP WOLTERS ENTERPRISES, INC.,
Petitioner,

versus

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Petition for Review of Decision of The Tax Court of the United States (District of Texas).

(February 29, 1956.)

Before HUTCHESON, Chief Judge, and RIVES and CAMERON, Circuit Judges.

HUTCHESON, Chief Judge: This appeal by the taxpayer from a decision and order[1] of the Tax Court, redetermining petitioner's tax liability for the fiscal years ending March 31, 1948 and 1949, presents for our decision a single question, the correct basis for depreciation and gain or loss of certain contracts acquired by it in 1947 from its stockholders.

Urging upon us that the Tax Court's decision is erroneous and may not stand, petitioner thus poses the question and states the answer:

> "What was Petitioner's basis for gain or loss, and depreciation, of the Camp Wolters' buildings, equipment, and materials acquired by Petitioner from the United States in 1947, viz., Was such basis $827,354.20, as contended by Petioner, or $466,274.00, as found by the Tax Court of the United States?"
>
> "The answer to this question turns on whether certain promissory notes totaling $411,080.20 (hereinafter sometimes referred to as 'building notes') issued by Petitioner in 1947 in payment for sundry claims against the United States were 'securities' within the meaning of Sec. 112(b)(5) of the Internal Revenue Code of 1939, as found by The Tax Court of the United States, or whether such notes were mere purchase money obligations, as contended by Petitioner.

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[1] 22 T.C. 736.

"Since the claims acquired by Petitioner with such notes, together with cash totaling $412,500. were turned over to the United States in 1947 in payment for Camp Wolters' buildings, equipment and materials (the major portion of which were sold, and the balance of which depreciated. within the taxable years involved in this proceeding), Petitioner contends that the Camp Wolters' buildings, equipment and materials cost it $827,-354.20 made up of: (1) the cost to it ($412,500 in cash and notes) of the claims surrendered in part payment for the Camp Wolters' buildings, equipment, and materials; (2) the cash in the sum of $412,500 paid to the United States; and (3) other miscellaneous costs amounting to $2,354.20."[2]

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[2] In support of this view, it thus summarizes its argument:

"The underlying facts in the case at bar are not in dispute. The Only issue between the parties is one of law. The parties agree:

"(1) That Petitioner's basis for the Camp Wolters' buildings, equipment, et cetera, is the total of the cash paid therefor, plus Petitioner's basis, whatever that may be as a matter of law, for the restoration rights acquired by Petitioner and given by it as part consideration for Camp Wolters' buildings, equipment and materials, and miscellaneous other costs totaling $2,350.00.

"(2) That Petitioner is entitled to allocate its aggregate cost or basis for the Camp Wolters' buildings, equipment and materials over the assets acquired and to compute gain or loss from sales and the depreciation sustained in the two taxable years before the Court on the basis of such allocated cost.

"Once Petitioner's total cost or basis for gain or loss and depreciation of the Camp Wolters' buildings, equipment and materials has been fixed, the parties are in agreement

as to how such cost or basis should be allocated or apportioned over the several items of buildings, equipment and materials involved. Further, they are in agreement as to the useful life of the depreciable property involved. The sole difference between the parties, therefore, concerns the cost basis to Petitioner of the restoration rights surrendered by it as part consideration for the Camp Wolters' buildings, equipment and materials which cost or basis, in turn, fixes that portion of Petitioner's cost or basis for gain or loss, and depreciation, of the Camp Wolters' facilities, represented by Petitioner's expenditures in acquiring such rights.

* * * * *

* * * "If the buildings notes hereinabove referred to constituted 'securities' of petitioner corporation in the sense that that term is used in Sec. 112(b)(5) of the Internal Revenue Code of 1939 the decision below should be affirmed. If, on the contrary (as contended by Petitioner) *the notes in question did not constitute 'securities' within the purview of the mentioned statute, but were ordinary purchase money obligations*, then Petitioner correctly reported the cost to it of buildings and equipment salvaged and sold in its fiscal years ended March 31, 1948 and 1949, and the amount of depreciation sustained by it on those assets used in its rental business in the taxable years before the court and the decision below should be reversed. (emphasis supplied)

"The question of the meaning of the term 'securities' as used in various revenue statutes has been considered by the courts in a number of cases. The rule appears to be well settled that, where such an act does not define the term, *it denotes an obligation of a character giving the creditor (because of the issuance of such obligations) some assured participation in the business and that the term does not include evidence of indebtedness for short-term loans, or evidence of indebtedness representing temporary advances for current corporate needs.* Pinellas Ice and Cold Storage Co. v. Commissioner, 287 U.S. 462; Cortland Specialty Co. v. Commissioner, 60 F(2) 937; certiorari denied 288 U.S. 599; L. E. Stirn, Inc. v. Commissioner, 107 F(2) 390; Commissioner v. Sisto Financial Corp. 139 F(2) 253.

"The test as to whether notes are securities is not a mechanical determination of the time period of the note. Though time is an important factor, *the controlling considera-*

The commissioner, on his part, insisting: "The Tax Court correctly determined the basis of the rights acquired by taxpayer from its stockholders to be the same as in the hands of the transferor stockholders, not the face amount of notes issued in exchange.", thus states the question for decision:

> "Whether property (contract rights) acquired by taxpayer corporation from its stockholders upon its organization, in exchange for cash and notes, was acquired in an exchange falling within Section 112(b)(5) and (c)(1) of the Internal Revenue Code of 1939, so as to require taxpayer under Sec. 113(a)(8)(A) to carry over the stockholder-transferor's basis for the property, with adjustments. The answer depends on whether

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tion is an overall evaluation of the origin and nature of the debt, the degree of participation and continuing interest in the business and the extent of the proprietary interest (arising because of the issuance of an obligation), the purpose of the advances, and other like considerations.

"It is entirely within the discretion of the incorporators of a corporation, or the stockholders of an existing corporation, as to how much capital they wish permanently to embark in the operation of the business of the corporation, and whether other advances required for corporate purposes should be made in the way of loans. Stated in another way, it is entirely within the discretion of the incorporators, or stockholders of a corporation, as to whether they wish to transfer property to the corporation as paid-in capital or whether they prefer to sell the same to the corporation for a consideration to be paid to them by the corporation as purchase price. This is made abundantly clear by two very recent decisions of this court, namely, John D. Rowan, et al v. U. S., 219 F(2) 51, and Sun Properties, Inc. v. U. S., 220 F(2) 171." (emphasis supplied)

(as the Tax Court unanimously held) the notes issued in exchange for the property constituted 'securities' within the meaning of Sec. 112(b)(5)."

"The ultimate issue on this appeal is the correct basis to taxpayer corporation, for purposes of determining depreciation and gains from sales, of certain contract rights acquired upon its organization in 1947 from its stockholders. The rights acquired consisted of (1) the right under a purchase agreement with the Federal Government to buy, for cash plus a release of the so-called restoration rights, buildings and other improvements erected by the Government as lessee of lands known as Camp Wolters; and (2) the restoration rights, i.e., the right under the terms of the lease to require the lessee-Government to dismantle the buildings and improvements and restore the leased premises to their original condition. The issue turns on whether these rights were acquired by taxpayer pursuant to a tax-free exchange falling within the provisions of Sec. 112(b)(5) and (c)(1) of the Internal Revenue Code of 1939, and this in turn depends on whether the notes issued by taxpayer in exchange for the rights constituted 'securities' within the meaning of Sec. 112(b)(5). If the rights were acquired in a Sec. 112(b)(5), 112(c)(1) exchange, then under Sec. 113(a)(8)(A)

the basis to taxpayer is the same as in the hands of the transferor-stockholders."

The commissioner thus summarizes his argument in support of this view:

"The Tax Court correctly held that the transfer of property (restoration rights) to taxpayer corporation by its stockholders in exchange for cash plus notes constituted a tax-free exchange falling within Sec. 112(b)(5) and (c)(1) of the Internal Revenue Code of 1939, and that consequently taxpayer was required under Section 113(a)(8)(A) to use the transferor-stockholders' basis for the property with adjustment for the cash boot received) in computing depreciation and gains from sales. The control and proportionate interest requirements of Sec. 112(b)(5) admittedly were met; and the record fully supports the Tax Court's unanimous conclusion that the other requirement was also met, namely, that the property was transferred for 'stock or securities'. The comprehensive term 'securities' is used in Sec. 112(b)(5) in its ordinary and generally accepted sense. It embraces all classes of debt instruments, including bonds, debentures and notes, except those of such short duration as to make them essentially equivalent to a payment in cash. Under the decisions of the Supreme Court and other courts, the Tax Court properly concluded that the series of eighty-nine notes here involved were 'securities' received upon a tax-free exchange within the purview of Sec. 112(b)(5), rather than the equivalent of cash received upon a taxable sale. The notes were payable in installments from five to nine years after issue, were unsecured and payable pro rata only out of available funds, and were subordinated to a large bank loan. They were no less 'securities' than other debt instruments which have been held to fall in that category. The various theories upon which taxpayer seeks to exclude the notes from the category of 'securities' find no support in the statute or the decisions or elsewhere. The cases upon which it relies are not comparable, since they involved short-term loans; moreover, they turned on whether the 'continuity of interest'

The material facts are not in dispute, and since the opinion of the Tax Court sets them all out in detail, it will be sufficient to state them here only in briefest summary.[4]

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requirement of a corporate reorganization had been met —a question not here presented—rather than on whether the instruments involved constituted 'stock or securities' received upon a Sec. 112(b)(5) exchange."

[4] The issue arises in the following manner. The City of Mineral Wells leased certain land and then subleased it to the Government, which built extensive improvements. The lease gave the City an option to purchase the land, and the sublease required the Government upon its termination to remove the buildings and restore the premises to their original condition. When, early in 1946, the Government decided to deactivate Camp Wolters, a group of eighty-nine persons, the Dennis group, acting through an agent (Mims) acquired the City's option to purchase and then exercised the option by paying $151,000 to the original lessors for both the land and the appurtenant restoration rights. The Dennis group then contracted to purchase from the Government the buildings and improvements which the latter had erected on the land, for $412,500 cash plus a release of the restoration rights and shortly thereafter organized the taxpayer corporation with a total capital and surplus of $204,240 paid in out of the Group fund, and all of taxpayer's stock was issued to the eighty-nine members of the Group in proportion to their respective contributions to the Group fund. A few days after taxpayer's incorporation, the stockholders transferred to it the land, the contract right to purchase the buildings and improvements, and the restoration rights. In exchange for the land taxpayer gave them eighty-nine 'land notes' totaling in face amount $151,336, and took this as its basis for the land and no controversy is presented with respect to this. In exchange for the rights it gave them eighty-nine 'building notes' totaling in face amount $411,080 plus $1424 in cash. Taxpayer then borrowed $325,000 from a bank (to which loan the notes were subordinated) and promptly carried out the contract to purchase the improvements by pay-

Building upon this framework of undisputed facts and disputed contentions, petitioner and respondent each labors mightily to bring us to his view, petitioner insisting: that it is a complete misapprehension of the facts and as complete a distortion of the language and sense of the statute to find and hold, as the Tax Court did, that the notes were, within its meaning, securities and that a tax free exchange resulted; while respondent, on its part, insists that petitioner's position is untenable, the Tax Court's decision is unassailable.

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ing to the Government $412,500 cash and surrendering the restoration rights.

"In its returns for the taxable years, for purposes of computing depreciation and gains from the sales of the buildings and improvements, taxpayer included in its basis the sum of $827,354, consisting of (1) the $1424 cash paid to its stockholders for assignment of the purchase and restoration rights; (2) the $411,080 face amount of building notes issued to the stockholders as additional consideration for those rights; (3) the $412,500 cash purchase price paid to the Government under the purchase contract; and (4) $2,350 of additional cash expended. The Commissioner accepted all of the above components except item (2) above, namely the amount of the building notes. The Tax Court, in a decision reviewed by the full court, unanimously sustaining it in part, held: that taxpayer acquired the purchase and restoration rights from its stockholders pursuant to tax-free exchange under Sec. 112(b)(5); that consequently, by virtue of correlative Sec. 113(a)(8)(A), taxpayer's basis for those rights was the same as in the hands of the transferor-stockholders (which is found to be 50,000) plus the amount of gain (the $1424 cash boot received by the stockholders) recognizable upon the exchange under Sec. 112(c)(1).

While petitioner, in its argument, es correctly state the test as to whether notes ar curities, we think it clear that, too greatly preoc ed with the name given to and the time periods in this case, it has, with foreshortene e securities see the picture whole. Giving little o ze, failed to to the fact that the notes did not evi recognition transaction of purchase and sale, hav an isolated after the forming and launching of its inception but were an integral part of the sche corporation, and financing, petitioner has wholl its forming test to the undisputed facts that petiti applied the into being for the sole purpose of o was brought stockholders in exchange for cash an ng from the and notes, the properties of the ent rities, stock the buildings and the rights. e, the lands.

Perhaps the main, certainly the m
pect of petitioner's preoccupation is portant, as-
that in forming and launching the c ilure to see on money paid in by, but in much l tion, in part given to its stockholders, the givin art in notes not a separate purchase from the st notes was upon and made after the corporate ers, decided formed and launched, but was an pot luck no pay no cure plan, formd been fully tion, of launching petition with ca part of the note form. e incorpora-
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This preoccupation appears thr
petitioner. It is particularly evid
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re, after cor-

rectly stating, "The rule appears to be well settled that where such an act does not define the term 'securities' it denotes an obligation of a character giving the creditor, because of the issuance of such obligation, some assured participation in the business and that the term does not include evidence of indebtedness for short term loans or evidences of indebtedness representing temporary advances for current corporation needs.", petitioner fails to correctly apply it because it fails to see that that is exactly what occurred here, to-wit: the "rights" notes, the land notes and the stock were together different forms of the assured participation in the pot luck of the enterprise. The notes did not represent "evidence of indebtedness either for short term loans" or "temporary advances for current corporate needs". They, the stock and the cash were equally evidence of participation.

We are of the opinion that the Tax Court answered the question correctly and that for the reasons so carefully and correctly stated by it, its decision and order should be affirmed. We particularly agree with these statements in its opinion:

> "The test as to whether notes are securities is not a mechanical determination of the time period of the note. Though time is an important factor, the controlling consideration is an overall evaluation of the nature of the debt, degree of participation and continuing interest in the business, the extent of proprietary interest compared with the similarity of the note to a cash payment, the

purpose of the advances, etc. It is not necessary for the debt obligation to be the equivalent of stock since Sec. 112(b)(5) specifically includes both 'stock' and 'securities'.

* * * * *

"In the instant case, the petitioner issued 89 non-negotiable unsecured installment notes in exchange for assignment of the 'contract' and restoration rights of April 7, 1947, four days after petitioner was incorporated. The 'contract' and restoration rights constituted permanent contributions to petitioner's business, not merely temporary advances of rights to be used for current needs. These interest-bearing notes became due in five equal annual installments between the fifth and ninth year after issuance. Petitioner had the privilege of paying the notes off before the due date, subject to two general provisions: (1) Any payment on the notes had to be on a pro rata basis for the entire series of 89 notes; (2) petitioner borrowed $325,000 from the Republic National Bank and no payment whatsoever was to be made on the notes until the $325,000 loan and any renewals, extensions, or refinancing had been completely liquidated. In other words, the latter requirement imposed a condition precedent to the due date of the notes. In the event petitioner had been unsuccessful and unable to pay off the prior loan, the holders of the

89 notes had no right to demand the insta
payments on the due dates. It seems cle
the noteholders were assuming a substanti
of petitioner's enterprise, and on the date
suance were inextricably and indefinitel
up with the success of the venture, in so
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fact, all 89 notes were redeemed within two
but we must examine the notes as of the
issuance. Having considered all the fac
conclude that the 89 notes constitute 'sec
under Sec. 112(b)(5) and that, consequent
transaction falls within the provisions o
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RMED.

The judgment is right. It is AFFIRMED.

A True Copy:
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an, Jr.
l States Court of
Fifth Circuit.

/s/ John A. Feehan, Jr.
Clerk of the United States Co
Appeals for the Fifth Circ

JUDGMENT.

Extract from the Minutes of February 29th., 1956.

CAMP WOLTERS ENTERPRISES, INC.,

No. 15453 versus

COMMISSIONER OF INTERNAL REVENUE.

This cause came on to be heard on the petition of Camp Wolters Enterprises, Inc., for a review of a decision of the Tax Court of the United States, and was argued by counsel;

On consideration whereof, It is now here ordered, adjudged and decreed by this Court that the judgment of the said Tax Court in this cause be, and the same is hereby, affirmed.

* * * * * * * * * *

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390153—56——1

In the Supreme Court of the United States

OCTOBER TERM, 1956

No. 121

CAMP WOLTERS ENTERPRISES, INC., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 22–57) are reported at 22 T. C. 737. The opinion of the Court of Appeals (Pet. 16–28) is reported at 230 F. 2d 555.

JURISDICTION

The judgment of the Court of Appeals was entered on February 29, 1956. (Pet. 29.) The petition for a writ of certiorari was filed on May 28, 1956. The jurisdiction of this Court is invoked under 28 U. S. C. 1254.

QUESTION PRESENTED

Whether property acquired by taxpayer corporation from its stockholders upon its organization, in ex-

change for cash and notes, was acquired in an exchange falling within Section 112 (b) (5) and (c) (1) of the Internal Revenue Code of 1939, so as to require taxpayer under Section 113 (a) (8) (A) to carry over the stockholder-transferors' basis for the property, with adjustments. The answer depends on whether the notes issued in exchange for the property constituted "securities" within the meaning of Section 112 (b) (5).

STATUTE INVOLVED

The pertinent portions of Sections 112 and 113 of of the Internal Revenue Code of 1939 are set forth in the Appendix, *infra*, pp 13–15.

STATEMENT

The material facts as found by the Tax Court (R. 26–43) and the Court of Appeals (Pet. 23–24) may be summarized as follows:

Prior to World War II, as a step in its preparedness program, the United States became interested in acquiring land near the City of Mineral Wells, Texas, to be used as an army induction and training center. The City proceeded to acquire leases from various land owners, with a view to giving a master sublease to the Government. Each lease obligated the lessee upon its termination to restore the premises to their original condition, and also granted an option to purchase the premises for a stated consideration. (R. 27–28.) When the desired acreage was assembled, the City subleased it to the Government by a single master lease under which the Government assumed the restoration obligations contained in the original leases.

(R. 28–29.) The Government took possession of the land and built thereon an extensive induction and training center, known as Camp Wolters. (R. 29–30.)

Early in 1946 the Government decided to deactivate Camp Wolters and, in order to restore the premises to their original condition, was contemplating dismantling the buildings and improvements at great cost. A plan was formulated by one Dennis and several other individuals (hereafter sometimes called the Dennis Group or the Group) to acquire the City's option to purchase the land from the original lessors, together with the so-called restoration rights,[1] and then to purchase the buildings and other improvements from the Government. A total of eighty-nine individuals joined the Dennis Group and they invested approximately $356,000 under the plan. (R. 30–32.) All of the Dennis Group's assets were held in common, each member's share being in proportion to his contribution. (R. 33.)

Pursuant to the plan, the City's option to purchase the land was assigned to one Mims, acting as nominee for the Dennis Group. Mims then exercised the option by purchasing the land and the restoration rights for a total price of $151,000. Of this amount, $50,000 was paid for the restorations rights, and this sum constituted the Dennis Group's basis for those rights. In March of 1947 the Group through Mims then contracted with the Government for the right to pur-

[1] For convenience, the lessors' rights to compel the Government to demolish the buildings and improvements and otherwise restore the premises to their original condition will be referred to as the "restoration rights."

chase all of the physical assets located on the land for $412,500 cash, plus a release of the restoration rights. (R. 32–33.)

Shortly thereafter, on April 3, 1947, the taxpayer corporation was organized by the Dennis Group. All of its capital, consisting of $14,240 par value stock plus $190,000 of paid-in capital surplus, came from the Group fund. A few days later (April 7) Mims conveyed the lands (without the restoration rights) to taxpayer, in consideration of eighty-nine "land notes" in the total face amount of $151,336.88. On the same day Mims also assigned to taxpayer the Government contract and the restoration rights, in consideration of $1,424 in cash and eighty-nine "building notes" in the total face amount of $411,080.20. The gain realized by the Dennis Group on the transfer was at least equal to the $1,424 cash paid to Mims. (R. 33–36.)

The notes were nonnegotiable, bore four per cent interest, and were payable in five equal annual installments five, six, seven, eight, and nine years after issue. They were unsecured, payable only "on a pro-rata basis out of property or funds available for payment on the entire series of notes," and were subordinated to a $325,000 secured bank loan. They contained the usual provisions for accelerated maturity on default, attorneys' fees, interest on unpaid interest, and gave the obligor the privilege of pre-paying principal. (R. 36–39.)

On or about April 15, 1947, taxpayer exercised the right to purchase the buidings and improvements by paying the Government $412,500 in cash and releasing the restoration rights. An additional $2,350 was

expended in connection with the
40.) 39–

All of taxpayer's 1,424 share
eighty-nine land notes and eighty
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In its income tax returns for the
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$412,500 cash purchase price paid t
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reduced the basis by the amount of t
and accordingly determined the bas
(R. 40.) The Tax Court, in a deci
the full court, unanimously sustained
er's determination, but only in part.
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be carried over as part of taxpayer's basis, under the provisions of Sections 112 (b) (5) and (c) (1) and 113 (a) (8) (A) of the Internal Revenue Code of 1939. Accordingly, the Tax Court allowed a basis of $466,274, instead of the $416,274 allowed by the Commissioner and the $827,354.20 claimed by the taxpayer. (R. 43–57.) The Court of Appeals affirmed. (Pet. 16–28.)

ARGUMENT

The decision below, affirming that of the Tax Court, is clearly correct. There is no conflict, and no occasion for further review.

1. Section 112 (b) (5) of the Internal Revenue Code of 1939 (Appendix, *infra*, p. 13) provides that no gain or loss is recognizable if (a) property is transferred to a corporation "in exchange for stock or securities in such corporation," (b) immediately after the exchange the transferors are in "control" of the transferee corporation, and, (c) in the case of more than one transferor, the amount of stock and securities received by each is "in proportion" to his interest in the property transferred. Section 112 (c) (1) (Appendix, *infra*, pp. 13–14) provides that if in addition to the property received tax-free on the exchange there is received "other property or money" (commonly referred to as "boot"), the gain is recognizable to the extent of the boot received. Correlative Section 113 (a) (8) (A) (Appendix, *infra*, pp. 14–15) provides that if the transaction falls within Section 112 (b) (5), then the "basis" of the property transferred shall be "the same as it would be in the hands

of the transferor", increased by the amount of gain recognized to the transferor under Section 112 (c) (1).

The ultimate issue in this case is the correct basis to taxpayer corporation, for purposes of determining depreciation and gains from sales, of certain contract rights acquired upon its organization from its stockholders. The rights acquired consisted of (1) the right under a purchase agreement with the Government to buy, for cash plus a release of the so-called restoration rights, buildings and other improvements erected by the Government as lessee of lands known as Camp Wolters; and (2) the restoration rights, i. e., the right under the terms of the lease to require the lessee-Government to dismantle the buildings and improvements and restore the leased premises to their original condition. The issue turns on whether these rights were acquired by taxpayer pursuant to a tax-free exchange falling within the provisions of Section 112 (b) (5) and (c) (1), and this in turn depends on whether the notes issued by taxpayer in exchange for the rights constituted "securities" within the meaning of Section 112 (b) (5).[2] If (as both courts below held) the rights were acquired in a Section 112 (b) (5)–112 (c) (1) exchange, then under Section 113 (a) (8) (A) the basis to taxpayer is the same as in

[2] It is undisputed that the contract rights which the stockholders transferred to taxpayer corporation constituted "property" as that term is used in Sections 112 (b) (5) and 113 (a) (8) (A); that the "control" and "proportionate interest" requirements of Section 112 (b) (5) were met; and that gain was recognizable under Section 112 (c) (1) (and the basis of the property was correspondingly to be increased under Section 113 (a) (8) (A)) to the extent of the cash boot ($1,424) received on the exchange.

olders, with adjust-
the hands of the transferor-stockholders, w acquired by a tax-
ments not here in controversy; if acquire er contends), then
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taxpayer's basis is the cost to it, i. e., the the exchange.
value of the rights at the time of the exch l the Tax Court's

The court below correctly affirmed the notes" issued by
determination that the "building notes" lers upon its for-
taxpayer corporation to its stockholders up e and restoration
mation, in exchange for the purchase and n the purview of
rights, constituted "securities" within the ion uses the com-
Section 112 (b) (5). Since that section usities", the word
prehensive phrase "stock or securities" ething besides a
"securities" obviously denotes something is used in Sec-
proprietary stock interest. The term is u accepted sense,
tion 112 (b) (5) in its ordinary and acc instrument evi-
i. e., as referring to any corporate inst erprise. It em-
dencing an investment in the enterpri including bonds,
braces all classes of debt instruments inclse of such short-
debentures, and notes except only those o ivalent to a cash
term as to make them essentially equival . S. 387; *Burn-*
payment. *Helvering* v. *Watts*, 296 U. S. A. 7th), certio-
ham v. *Commissioner*, 86 F. 2d 776 (C. A ner v. *Neustadt's*
rari denied, 300 U. S. 683; *Commissioner Commissioner* v.
Trust, 131 F. 2d 528 (C. A. 2d); *Com missioner* v. *Ed-*
Freund, 98 F. 2d 201 (C. A. 3d); *Commis*); *Commissioner*
monds' Estate, 165 F. 2d 715 (C. A. 3d);); *Commissioner*
v. *Bachrach*, 182 F. 2d 261 (C. A. 7th);), certiorari de-
v. *Kitselman*, 89 F. 2d 458 (C. A. 7th),
nied, 302 U. S. 709.

The building notes here involved u unquestionably
constituted "securities" as that term m is commonly
understood and used in Section 112 (b)), and as inter-

preted in the above cases. They consisted of a series of eighty-nine unsecured non-negotiable four per cent notes payable in annual installments between five and nine years after date of issue. They were issued by taxpayer to its eighty-nine stockholders in proportion to their stock holdings, were payable only on a pro rata basis and only out of "available" funds, and were subordinated to a large bank loan. (R. 36–39, 51–52.) Under no tenable theory may such notes be regarded as the equivalent of cash; they represented an investment in taxpayer's business and were securities in every sense of the term. As the Tax Court observed (R. 52), "It seems clear that the noteholders were assuming a substantial risk of petitioner's enterprise, and on the date of issuance were inextricably and indefinitely tied up with the success of the venture, in some respects similar to stockholders." In agreeing with the Tax Court, the court below properly pointed out (Pet. 25–26) that taxpayer corporation was brought into being for the sole purpose of obtaining from the stockholders all of the properties of the enterprise in exchange for its stock and notes and some cash, and that the notes "were equally evidence of participation" in the enterprise.

Nothing in the statute or its history or the decisions supports taxpayer's contention (Pet. 10–13) that the instant transaction is to be viewed as a taxable sale for cash rather than as a tax-free exchange for "stock or securities", and both courts below properly rejected the argument. While an intercorporate transfer of assets in exchange solely for cash and "short-term" (four-month) notes has been held to constitute

a taxable sale rather than a tax-free reorganization (*Pinellas Ice Co.* v. *Commissioner*, 287 U. S. 462), no claim is or can be made here that the instant transaction falls in that class.[3] The notes here involved were not any the less "securities" than, for example, the debt obligations which were held to fall within that category in the *Watts, Neustadt's, Burnham* and *Freund* cases, *supra*. In the *Watts* case, bonds maturing between one and seven years, actually paid within four years, were held by this Court to be "securities", the Court stating that (296 U. S., at 389) "The bonds, we think, were securities within the definition and cannot be regarded as cash, as were the short term notes referred to in Pinellas * * *". Had the transferor-stockholders received additional stock of taxpayer in exchange for the rights transferred, the transaction unquestionably would have constituted a tax-free exchange within the purview of Section 112 (b) (5). That they received unsecured subordinated notes, in lieu of additional stock, does not transform the transaction into a taxable sale or exchange. In the one case, as in the other, the property is transferred "for stock or securities" of the transferee corporation within the meaning of Section 112 (b) (5).

2. Neither of the two cases upon which taxpayer relies for conflict involved the question here presented.

In *United States* v. *Leslie Salt Co.*, 350 U. S. 383, it was held that two promissory notes issued to insurance companies for loans were not subject to the doc-

[3] Although in both courts below taxpayer relied chiefly upon the *Pinellas* case, it makes no mention of that case in its petition.

umentary stamp tax imposed by 1939 Code Sections 1800 and 1801 (26 U. S. C. 1952 ed., Secs. 1800 and 1801) upon "all bonds, debentures, or certificates of indebtedness issued by any corporation" (p. 385). Pointing out that a previous statute explicitly levying a tax on promissory notes had been repealed, and "[t]aking the statute in light of its legislative and administrative history" (p. 388), this Court ruled that the stamp tax statute before it was not intended to apply to notes of the type there issued. There is no parallel between the stamp tax statute construed in *Leslie Salt* and the nonrecognition of gain provisions of the income tax statute here applicable—either as to language or purpose or background—and the considerations which this Court stressed in reaching its decision in that case are notably absent here.

Nor is there any conflict with *LeTulle* v. *Scofield*, 308 U. S. 415. In relying upon that case, taxpayer confuses the "continuity of interest" requirement of a tax-free corporate reorganization with the function and scope of the phrase "stock or securities" appearing in the nonrecognition provisions of Section 112 (b) (5).[1] It was there held that a taxable sale or exchange rather than a tax-free reorganization occurred when one corporation transferred all its prop-

[1] The instant case involves a Section 112 (b) (5) exchange, not a corporate reorganization. Nor does it present any problem of continuity of interest, i. e., retention by the transferor of a proprietary interest in the transferee corporation. The transferors of the rights for which the notes here involved were issued admittedly were the eight-nine members of the Dennis Group, and they admittedly constituted all of taxpayer's stockholders both before and after the transfer.

erty to another solely for cash and bonds, the transferor retaining no proprietary (stock) interest in the transferee. The decision rests basically upon the failure to fulfill the "continuity of interest" requirement of a corporate reorganization, not upon the absence of an exchange for "stock or securities" as that phrase is used in Section 112 (b). See *Helvering* v. *Limestone Co.*, 315 U. S. 179, 182–183; *Helvering* v. *Minnestota Tea Co.*, 296 U. S. 378, 384–385. It has no pertinency where as here the proprietary stock interest does not change hands but, on the contrary, property is transferred to a corporation by its stockholders and the transferor-stockholders are in control of the transferee corporation both before and after the transfer.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

SIMON E. SOBELOFF,
Solicitor General.
CHARLES K. RICE,
Assistant Attorney General.
HARRY BAUM,
KARL SCHMEIDLER,
Attorneys.

JUNE, 1956.

APPENDIX

Internal Revenue Code of 1939:

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General Rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) *Exchanges Solely in Kind.*—

* * * * *

(5) *Transfer to corporation controlled by transferor.*—No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation, and immediately after the exchange such person or persons are in control of the corporation; but in the case of an exchange by two or more persons this paragraph shall apply only if the amount of the stock and securities received by each is substantially in proportion to his interest in the property prior to the exchange.

* * * * *

(c) [As amended by Section 121 (d) (1) of the Revenue Act of 1943, c. 63, 58 Stat. 21] *Gain From Exchanges Not Solely in Kind.*—

(1) If an exchange would be within the provisions of subsection (b) (1), (2), (3), or (5), or within the provisions of subsection (1), of this section if it were not for the fact that the property received in exchange consists not only

of property permitted by such paragraph or by subsection (1) to be received without the recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

* * * * *

(h) *Definition of Control.*—As used in this section the term "control" means the ownership of stock possessing at least 80 per centum of the total combined voting power of all classes of stock entitled to vote and at least 80 per centum of the total number of shares of all other classes of stock of the corporation.

* * * * *

(26 U. S. C. 1952 ed., Sec. 112.)

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; except that—

* * * * *

(8) *Property acquired by issuance of stock or as paid-in surplus.*—If the property was acquired after December 31, 1920, by a corporation—

(A) by the issuance of its stock or securities in connection with a transaction described in section 112 (b) (5) (including, also, cases where part of the consideration for the transfer of such property to the corporation was property or money, in addition to such stock or securities), or

(B) as paid-in surplus or as a contribution to capital, then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made.

* * * * *

(26 U. S. C. 1952 ed., Sec. 113.)

U. S. GOVERNMENT PRINTING OFFICE: 1958